Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington DC 20554

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In the matter of Implementation of the Telecommunications Act of 1996 Accounting Safeguards under the Telecommunications Act of 1996	CC Docket No. 96-150

REPLY COMMENTS OF AMERITECH

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CC Docket No. 96-150

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Table of Contents

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SUMMARY

The Commission's Joint Cost Rules were adopted to counteract what was perceived as the opportunity and incentive on the part of monopoly carriers to allocate to their regulated operations costs that properly should have been attributed to their nonregulated, competitive businesses. Those rules were adopted under rate-of-return regulation. Ameritech showed in its initial Comments those rules are no longer necessary for no-sharing price cap carriers, especially in the new realm of competition for local services, and no commenter has succeeded in refuting that analysis. Thus the incentives that led to the adoption of the Joint Cost Rules have been abruptly attenuated by the advent of no-sharing price caps and by the increased likelihood of a competitive local exchange market under the Telecommunications Act of 1996, and accordingly the Commission should forbear from application of those rules.

Also, even if the Commission does not forbear from enforcing the rules in their entirety, it should adopt the simplified and streamlined form of the rules proposed in the Comments of the United States Telephone Association.

Furthermore, if the Commission decides nevertheless to retain the present Joint Cost Rules as a redundant double protection against the risks of cross-subsidy, it should reject changes in those rules that would merely make them more burdensome. The existing rules have served their purpose and are familiar to the Commission, the carriers, and their competitors, and they should remain as they are.

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I. The Commission Should Forbear from Regulation, Streamline the Rules As USTA Has Proposed, Or Leave the Rules As They Are.

As the Commission has observed, the threshold issue in this proceeding is the continued applicability of the rules for price cap carriers (NPRM at ¶¶ 11, 121). Ameritech in its initial Comments showed that neither the Part 32 Affiliate Transaction Rules or the Part 64 Cost Allocation Rules (the Joint Cost Rules) continue to be necessary, and no commenter has succeeded in refuting that analysis. As a result, the Commission should forbear from regulation, or alternatively, adopt the streamlining proposal contained in the Attachment to the Comments of the United States Telephone Association ("USTA"). At a minimum, the Commission should not adopt the modifications to its affiliate rules; instead, the rules should be left as they are.

A. *The Commission Should Forbear from Regulation For No-Sharing Price Cap Carriers.*

Ameritech showed in its comments that since Ameritech is under no-sharing price caps in both the interstate and state jurisdictions, there is zero risk of cross-subsidy, and the four circumstances under which a carrier could misallocate costs, as hypothesized in the NPRM, do not apply to Ameritech (Ameritech Comments at 4–8). Other commenters operating under price caps asserted that since the link between costs and rates is broken, the incentive to misallocate costs is virtually nonexistent, for there would be no practical advantage to doing so (*see* Pacific at 40–42, SBC at 5–7, Bell Atlantic at 3–4; *see also* USTA at 5).

B. *Arguments for a Continuing Need for the Joint Cost Rules Are Self-Serving and Unpersuasive.*

Interexchange carriers, state commissions, and other parties support the continued application, with the proposed modifications, of the Joint Cost Rules. Of course, it is not without significance that many of these commenters will be competing in the local and interexchange marketplace with the incumbent local exchange carriers ("ILECs") and will benefit from loading down the ILECs with the administration of costly rules. AT&T, for example, states that the rules are useful to calculate sharing amounts and the productivity factor and to give some protection to access ratepayers, interconnectors, new entrants, and competition (AT&T at 2). MCI and LDDS WorldCom raise the specter of passing the costs of competitive services through to the captive LEC customers through cost misallocations (MCI at 4; LDDS at 11). Other commenters, such as Comptel, incorrectly tie concerns about cost shifting to the Commission's interconnection initiative, maintaining that ILECs have an incentive to maximize the total element long run incremental cost ("TELRIC") based price (Comptel at 7, New York Department of Public Service ("NYDPS") at 10, Public Service Commission of Wisconsin ("Wisconsin PSC") at 10–11).

As Ameritech stated in its Comments, there may arguably be some need for the Joint Cost Rules for carriers under price caps with sharing (Ameritech at 5) although, with the intensity of competition that is already here and more on the horizon, even that eventuality appears unlikely. As USTA argued, since price caps with competition provides the more effective constraints against cross-subsidy, the Joint Cost Rules are largely superfluous (USTA at 4, SBC at 5). There is certainly no reasoned basis to invoke the captive ratepayer concern. Even the term "captive ratepayer" is rooted in a cost-of-service, rate-of-return regulatory framework and is contrary to the current mode of price cap regulation and the deregulatory policy framework the Commission is mandated to implement.

AT&T and MCI argue that misallocations of costs impact a carrier's productivity and as such, there is a continued linkage between costs and rates to justify the continued application of the Joint Cost Rules (AT&T at 2, MCI at 5). Carriers operating under price caps have shown that there is no such linkage since the total factor productivity ("TFP") proposed by the industry uses total company data (Ameritech at 7, Pacific at 38–39, SBC at 7–10, BellSouth at 7–8, NYNEX at 2–6; *see also* USTA at 7).

Commenters have also argued for exogenous treatment of any reallocations of costs from regulated to nonregulated (MCI at 38). As Ameritech and other carriers have shown, however, any exogenous treatment for reallocations should be limited to what the rules currently require, *i.e.*, those associated with the shared forecast investment rules of Section 64.901(b)(4). Since the TFP methodology already includes the economies of scope, exogenous treatment would result in a double reduction in rates (*e.g.*, Ameritech at 10, Pacific at 38; *see also* USTA at 8).

With respect to the Commission's interconnection proceeding, since TELRIC is based on forward looking economic costs, attempts at cost shifting would be unavailing (See First Report and Order in CC Docket No. 96-98, released August 8, 1996, at ¶ 690–711).

In summary, as noted by SBC, the stated intent of Congress was to advance a deregulatory policy framework. If additional accounting regulations had been thought necessary by Congress, requirements for those additional regulations would have been included in the Act (SBC at 2–5). With this NPRM, the regulations would become even more intrusive than before the Act was passed. Price caps and competition are more than sufficient as a safeguard against cross-subsidy. The Commission should use this opportunity to forbear from regulation.

C. *USTA's Streamlining Proposal Is Reasonable and Consistent with the Act's Mandate To Adopt a Deregulatory National Policy Framework.*

The Commission should use this opportunity to streamline, if not forbear from applying, the Joint Cost Rules. Streamlining would conserve both Commission and ILEC resources and promote competition through the elimination of unnecessary costs. USTA's streamlining proposals are modest in scope and should be adopted.

Under USTA's streamlining proposals, no changes to the principles of the Joint Cost Rules contained in Section 64.901 are proposed. The only change is the elimination of the Shared Forecast Investment Rules, which, since they only have practical significance under cost-of-service regulation, are outmoded (The ARMIS report associated with the forecast required by § 43.21(e) is likewise eliminated.)

Also, under USTA's streamlining proposals, the only suggested change aligns current rules to the Act, wherein the filing and administration of the cost allocation manuals ("CAMs") is required. Section 11(b)(2)(B) of the Act states that CAMs should be filed annually. The related provisions, *i.e.,* 60-day approval period, quantification, and Common Carrier Bureau suspension of proposed changes, are eliminated by virtue of the annual filing.

USTA's proposal to reduce the frequency of the Joint Cost Audit required by Section 64.904 to every other year and alternate it with the biennial audit required by Section 272(d) will ensure that a carrier is audited every year. This eliminates duplication, thereby again conserving

Commission and ILEC resources without compromising the Commission's enforcement and oversight responsibilities.

Furthermore, the affiliate transaction rules would be modified to reflect the absence of any impact on a carrier's regulated rates in a price cap framework. The asymmetrical asset transfer rules are eliminated. These rules were adopted under cost-of-service regulation to ensure the regulated ratepayer did not bear any investment risk.[1] Under price caps, the ILEC is precluded from passing on any inflated purchase of assets, or benefiting from any inflated sale. Similarly, while retaining the valuation hierarchy, the proposed USTA rules are streamlined for services. These modest USTA changes recognize the deregulatory policy framework of the Act and can be consistently applied and audited.

D. In the Absence of Forbearance or Streamlining, the Rules Should Be Left As They Are, with No Modifications.

If the Commission determines that forbearance or streamlining should not be undertaken at the present time, the rules should be left as they are, with no modifications. The current rules already meet the Commission's parameters of being clear, consistent, and predictable, and

[1] *See* Order on Reconsideration, CC Docket 86-111, released October 16, 1987, at ¶ 109.

no party has met the NPRM's "heavy burden" test (NPRM at ¶ 12). The NPRM actually does not go far enough in establishing principles for evaluating the current applicability of the rules or modifying those rules. GTE's proposal on adopting a three-tier burden test for regulation— special showing of consistency with Congressional intent, clear public interest necessity, and lack of any less intrusive means to protect the public interest — while put in terms of the independent telephone companies, should be adopted for all carriers because it advances the deregulatory policy framework of the Act and promotes competition (GTE at 9).

The Joint Cost Rules were established nearly eight years ago, and were reaffirmed and strengthened on remand. As Pacific's comments have clearly laid out, those rules are manifested in procedures in place which are auditable, and for which the cost of a new system would outweigh any benefits and would not minimize the burden on carriers (Pacific at 3–6; *see also* SBC at 26–29, BellSouth at 6 n.13). Moreover, any new system would be inefficient, given price caps, and clearly contrary to the deregulatory mandate of the Act.

With respect to the NPRM's proposals to incorporate changes to the affiliate transactions rules similar to those proposed in Docket 93-251 nearly three years ago, the Commission has not met its own "heavy burden" test and the changes should be rejected for all the reasons advanced in the comments — unduly costly to administer, no record of abuse with the current rules, and contrary to previous Commission analyses (Ameritech at 17, USTA at 18, Pacific at 17–19, GTE at 4–6, Bell Atlantic at 7–9, BellSouth at 26–29 and Attachments, U S West at 17). More fundamentally, the modifications should be rejected because the premise on which they are based is flawed. The risk of cross-subsidy through the mechanism of passing misallocated costs on to ratepayers through higher rates is a practical impossibility due to price caps and competition.

Commenters supporting adoption of the modifications offer no reasoned justification to the contrary. LDDS states that price caps do not affect affiliate transactions or a carrier's incentive to shift costs to regulated, without further explanation (LDDS at 32). LDDS begs the question. The NPRM recognizes that affiliate transactions could impact price caps *if* costs could be passed on in higher rates — but, as previously shown, they cannot. Similar arguments that assert that the joint cost rules must be strengthened to ensure no cross-subsidy hang on this fatal flaw (American Public Communications Council at 2–6, Comptel at 4–7, AT&T at 14, Wisconsin PSC at 6–9). In addition, MCI maintains that the modifications should be adopted pursuant to the "arm's length" requirement of Section 272(b) (MCI at 21–23). But the Act requires no such level of detail (Bell Atlantic at 7–9).

II. Many Comments Range Far Beyond the Scope of the NPRM.

The Commission should not be diverted from evaluating whether the Joint Cost Rules should continue to apply by reason of the fact that many commenters highlighted issues barely tangential to the NPRM or far beyond its proper scope. The subject of this NPRM is the need for accounting safeguards to implement Sections 260 and 271–276 of the Telecommunications Act of 1996 and the form those accounting safeguards should take. The NPRM seeks comments on whether the current Joint Cost Rules should be adopted, adopted with modification, or eliminated. For the integrated operations of the Act, the Commission tentatively concluded that the Joint Cost Rules are sufficient. For the separated operations of the Act, the Commission proposed changes to the Part 32 Affiliate Transaction Rules similar to changes proposed three years ago in Docket 93-251.

The incumbent local exchange carriers (ILECs) commented extensively on the subject of the NPRM. Many of the other commenters, however, highlighted issues that are at best tangential to the subject of the instant NPRM and were rather the proper subject of the interrelated proceedings on implementing the non-accounting aspects of Sections 260 and 271 through 276, on matters where the record has previously been exhausted, or on matters wholly irrelevant. Additionally, some proposals, apart from their merits, would incorrectly apply to all affiliates instead of the affiliates required by Sections 272 and 274. The Commission should not be diverted from the subject matter of the instant proceeding with such digressive ploys. Whether and to what extent the Joint Cost Rules will suffice to meet the Act's requirements is the subject.

A. Some Comments Confuse This Docket with Others.

Several commenters used this proceeding to restate their concerns on why the in- region interLATA affiliate should be classified as dominant, the allowability and structure of service offerings, the non-discrimination provisions of the Act, pricing concerns under Sections 251 and 252 such as the establishment of price floors, retail prices of the interLATA affiliate, joint marketing concerns under Section 271 and a host of other issues clearly beyond the scope of the instant NPRM (LDDS at 2–3, 15, 21, AT&T at 3, Comptel at 18, Telemessaging Services International at 6–7, Sprint at 3). LDDS included virtually its entire comments from

CC Docket 96-149 in its comments here. These commenters' desire to avoid discussing the Joint Cost Rules suggests a paucity of reasoned justification for those rules' continued application.

B. Some Comments Reargue Issues Already Decided.

The American Public Communications Council (APCC) discussed at length various alleged deficiencies of the CAM and its processes, maintaining that the cost allocation methods are not sufficiently detailed, that the affiliate transactions listings have no detail, that the business activities of the affiliates are not provided, that the valuation methodologies are not listed, and the need for the assessment of royalty fees (APCC at 12-14). All of the deficiencies alleged by APCC have been subject to lengthy and voluminous proceedings with specific requirements codified in the rules, reviewed and reaffirmed on remand, reviewed for uniformity, subject to public review and comment with each CAM filing, and annual public reports supporting CAM methodologies that are subject to a mandatory annual independent audit and subsequent FCC review.[2]

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[2] *See* discussion at p. 8, *supra*.

C. Some Comments Are Wholly Irrelevant.

AT&T makes the observation that this NPRM does not address the more important conditions for competition such as access reform (AT&T at 3). APCC argues that the operational functions made available to LEC payphones must be made available to independent public payphone providers (APCC at 6). Telemessaging submits that guidelines on collocation must be established and alternative dispute resolution opportunities should be established (Telemessaging at 8-9). As with the previous two categories, such comments are well beyond the scope of this proceeding on accounting safeguards, and it would be a waste of Commission resources to consider them.

D. Some Comments Make Proposals Beyond 272 and 274 Affiliates.

Some proposals range beyond the subject of Section 272 and 274 affiliates. For example, AT&T proposes annual audits and public disclosure of financial information for all affiliates (AT&T at 11, 18). Telecommunications Resellers Association proposes that the BOCs and their affiliates initiate internal rules on anticipated costs including budget information and type of transactions quarterly and retained for one year (Telecommunications Resellers at 8). Apart from the merits of the proposals (discussed subsequently), extending the application to all affiliates would go far beyond the Act's requirements.

III. The Current Rules Are More Than Sufficient To Meet the Requirements of the Act.

A. *Safeguards for Integrated Operations*

1. TELEMESSAGING (SECTION 260(A)(1))

No party disputes that to the extent the Joint Cost Rules apply, they are sufficient. However, MCI is wrong in recommending that the BOCs should remove all the embedded costs for telemessaging from the Part 32 Accounts (MCI at 12). Telemessaging investment is already subject to the Joint Cost Rules, the investment for which is assigned to nonregulated within the regulated Part 32 Accounts.

2. INCIDENTAL INTERLATA TELECOMMUNICATIONS AND INFORMATION SERVICES

There is broad consensus that the Commission need not adopt either of its two accounting alternatives to accommodate the provisions of Section 271(h), *i.e.* a separate regulated category or treatment as nonregulated (Ameritech at 20, USTA at 20, Pacific at 10, SBC at 19-23).

Several commenters, however, disagreed on the basis of a need to track cost allocations. MCI, for example, proposed the creation of subsidiary accounts for interLATA services, while Comptel supported nonregulated accounting treatment (MCI at 14, Comptel at 10). As Ameritech and other commenters showed, the current rules are sufficient.

LDDS supports the NPRM on the accounting for access charge imputation required by Section 272(e)(3) (LDDS at 3). The NPRM's proposal of crediting the regulated exchange access revenue account and assigning the expense to nonregulated is inconsistent with Section 32.5280, Nonregulated Operating Revenue, of the Commission's rules, and should be rejected (Ameritech at 21, Pacific at 13).

LDDS supports the application of the Commission's Part 32 rules to the RBOCs and all affiliates (LDDS at 12). Others propose applying Part 32 to the Section 272 affiliates (AT&T at 9 n.9, MCI at 17, NARUC Appendix C, Page 12). It is not clear whom LDDS includes within the term RBOC. If LDDS means the holding company or any affiliate other than the BOCs, it is incorrect, because the Commission has determined that Part 32 applies only to the LECs, which includes the BOCs. Similarly, Part 32 does not apply to the Section 272 affiliate.[3]

LDDS maintains that where different rates are charged to unaffiliated companies, the RBOCs' integrated operations must pay the highest rate (LDDS at 17). As Ameritech showed in its reply comments in CC Docket 96-149, this would unnecessarily and unreasonably constrain a BOC affiliate from volume discount purchases (Ameritech Reply Comments in 96-149 at 30).

B. Safeguards for Separated Operations

1. Manufacturing and InterLATA Services

Many issues raised by the commenters, as previously discussed, are merely tangential to the NPRM and will not be repeated here. Several commenters, however, attempt to broaden the requirements of the Act and hamstring the BOCs with unnecessary reporting requirements and costly administrative detail. AT&T, for example, despite the

[3] *In re* Bell Operating Company Provision of Out-of-Region Interstate, Interexchange Services, CC Docket No. 96-21, Report and Order released July 1, 1996, at ¶ 23: "The Part 32 USOA, however, is not required to be kept by affiliates of a telephone company. These affiliates maintain their own separate books of account." *See also* Order, Authorization and Certificate, ITC-96-125, released July 24, 1996, at ¶ 18).

unambiguous statutory mandate of Section 272(d) for a biennial audit, maintains that the federal/ state joint audit should be done annually because there is nothing in the Act preventing annual audits and because they are necessary (AT&T at 17). AT&T does little to suggest why the audits should be annual other than to make unsubstantiated claims of the difficulty of identifying accounting irregularities and the lag in the distribution of audit reports. Increasing the frequency of audits, however, would do nothing to help the Commission's enforcement efforts because, as USTA showed, audits are only one of several enforcement and monitoring tools at the Commission's disposal, and to increase the frequency would only add an administrative burden on both the Commission and the BOCs (USTA at 4). In any event, USTA's streamlining proposal effectively results in an annual audit with the alternating of the Joint Cost Audit required by Section 64.904 and the Section 272 Biennial audit. The USTA proposal should be adopted (USTA at 14). Moreover, that there have been so few audits with some differences on the application of the Commission's rules is testament to the fact that the rules are effective and working as designed.[4]

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[4] *See* Docket 96-149 NPRM, released July 18, 1996, at ¶ 146, where the Commission, citing the same audits as AT&T, concluded, "Our experience to

(Footnote Continued . . .)

Several commenters suggest degrees of regulatory intrusion which have no basis in the Act and can only be viewed either as an attempt to saddle the BOCs with anticompetitive administrative costs or as an effort to obtain financial information to use against the BOCs in an anticompetitive manner. AT&T, for example, suggests that all BOC affiliates should publicly issue financial reports on a quarterly basis (AT&T at 18), while Telecommunications Resellers suggests that both BOCs and affiliates develop internal budget tracking rules on affiliate transactions (at 8). LDDS suggests that the earnings of each Section 272 affiliate be publicly disclosed (LDDS at 29). There is no requirement in the Act for these suggested requirements, and they should be summarily rejected.

MCI comments that the interLATA affiliate should be required to submit a cost allocation manual (CAM) (MCI at 34). This again is an effort to impose unnecessary administrative costs on a potential competitor. The services the interLATA affiliate will be providing are competitive and as such there is no justification for a CAM overlay (Ameritech at 24, Pacific at 29, SBC at 47, USTA at 24).

(Footnote Continued . . .)

date, however, has not disclosed a systematic pattern of anticompetitive abuses by independent LECs or the BOCs that would indicate that our safeguards are ineffective."

LDDS comments that additional measures in the form of special valuation methodologies should be adopted to recognize the regulated to regulated transaction between the BOC and the interLATA affiliate (LDDS at 28). Ameritech disagrees for the reasons explained in its comments (Ameritech at 24, Pacific at 29, U S West at 8). All the Commission need do is require the application of the Joint Cost Rules to these transactions.

Ameritech disagrees with LDDS that transaction records should be placed on the Internet (LDDS at 24). This is unnecessary to meet the statutory mandate of Section 272(b)(5) and, given the issue of the protection of confidential information on the Internet, would be impractical. Commenters support this assessment (*e.g.*, BellSouth at 24). Location of this information at a company designated office fully meets the statute's requirements for public availability. There is no requirement in the Act to make this information available on the Internet, and it should not be mandated (U S West at 13).

MCI comments that the rate of return used in the return component for affiliate transactions should be 10.25 percent, which is the low end adjustment amount under the Commission's price cap plan since it is the lowest earnings level a carrier can achieve without raising rates and an affiliate has reduced risk due to its affiliate relationship (MCI at 28). Ameritech disagrees. The authorized rate of return should be used in affiliate transactions unless the use of a different rate can be demonstrated in a carrier's CAM (USTA at 24). As BellSouth correctly points out, there may be some theoretical deficiency in assuming that the cost of capital of a nonregulated affiliate is equal to that of the regulated carrier (BellSouth at 35). However, for uniformity and ease of administration, use of the authorized rate of return of 11.25 percent has been adopted and should continue to apply. Also, there has been no showing that affiliates have reduced risk.

The audit requirements of Section 272(d) require no further specification and should be alternated with the Joint Cost Audit, as USTA recommends (USTA at 14, Ameritech at 25, Pacific at 31, BellSouth at 39, U S West at 26–27). In the absence of adopting the USTA proposal, the first biennial audit should commence two years after a carrier receives Section 271 authorization. Several commenters recommend that the biennial audit begin sooner. MCI, for example, states the audit should occur one year after in-region interLATA authorization (MCI at 37). Comptel maintains the audit should begin six months after in-region authorization (Comptel at 17). NARUC recommends the audit be conducted for the fiscal year after the new subsidiary begins service (NARUC at Appendix C, Page 15). However, there is no basis in the Act for commencing the audit any time sooner than two years after a company receives Section 271 authorization. The language of the statute is clear and unequivocal. If Congress had intended an audit every six months, every year, or any other time interval besides "every 2 years," it could have, and would have, so stated.

NARUC, supported by some state commissions, provides detailed audit guidelines to implement the biennial audit required by Section 272(d). (NARUC at Appendix C; *see also* Wisconsin PSC at 13–14, Missouri PSC at 10, Florida PSC at 4). The NARUC guidelines should be rejected for several reasons. The statute is clear with respect to what entity is to conduct the audit (it is to be ". . . conducted by an independent auditor . . ."), to whom the results of the audit are to be submitted, and access to documents. NARUC's guidelines are overly intrusive, exceed the statutory requirements, and are at an unprecedented micro-management level contrary to the deregulatory policy mandated by the Act.

There is nothing in the Act that even remotely suggests that the federal/state audit team, as NARUC recommends, receive periodic